

Why Was Europe Left at the Station When America's Productivity Locomotive Departed?

Robert J. Gordon

Northwestern University, NBER, and CEPR

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Two Big Themes

- Europe's Productivity Almost Caught up and is Now Falling Behind: In What Sectors is This Happening and Why?
- How Much Does Real GDP per Capita Understate European Welfare?
 - Interpretation of hours per capita
 - Other welfare differences

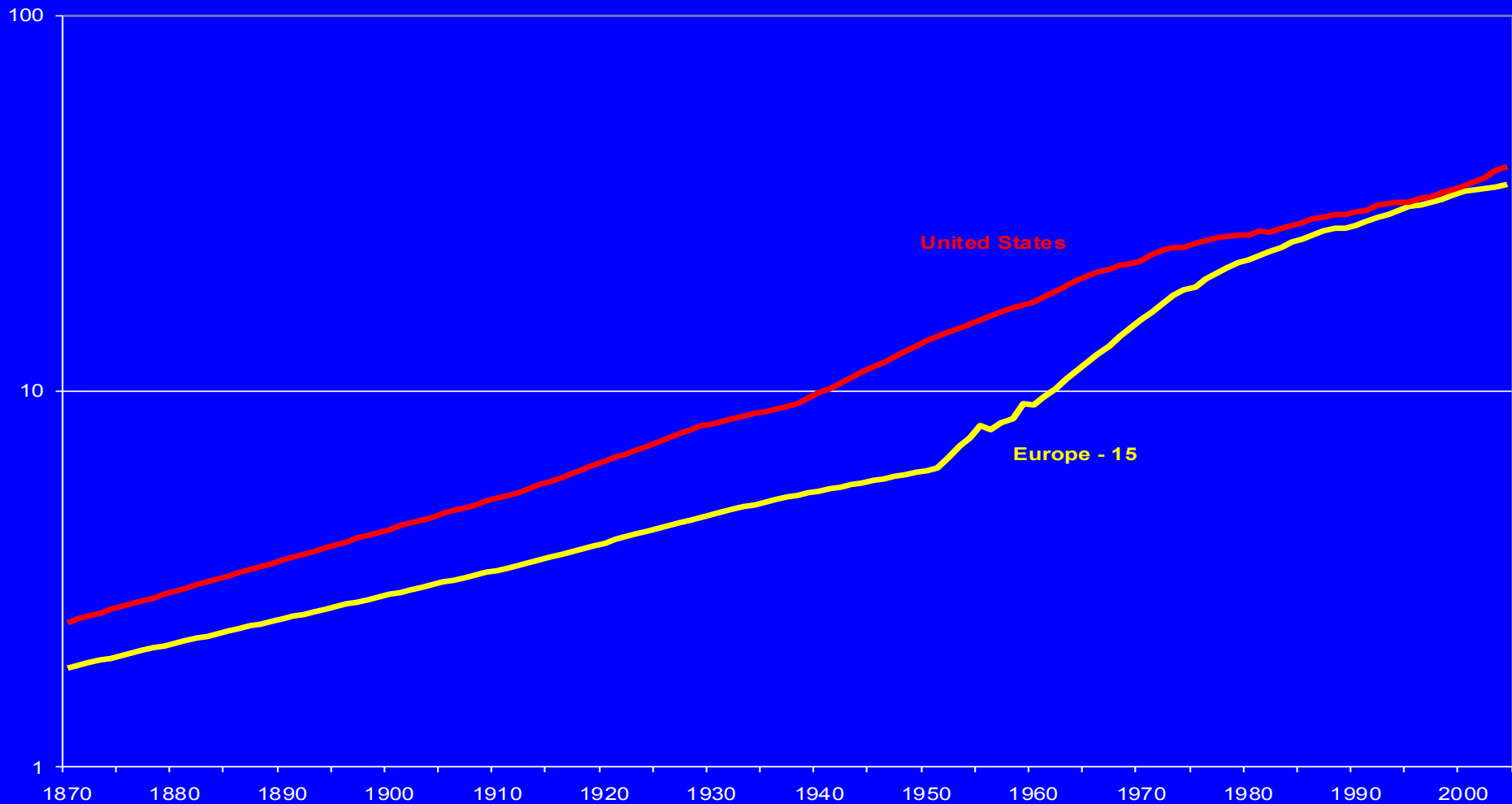
An Overriding Difference: The Consumer vs. the Producer

- The Fundamental Conflict between the Consumer and Producer.
- Everywhere you look, Europe protects the producer and penalizes the consumer
 - Wal-Mart as a Symbol. Protecting the Consumer while Squeezing the Employee to Achieve the “Low Prices Always”
 - Sitting in Europe vs. Standing in the U. S.

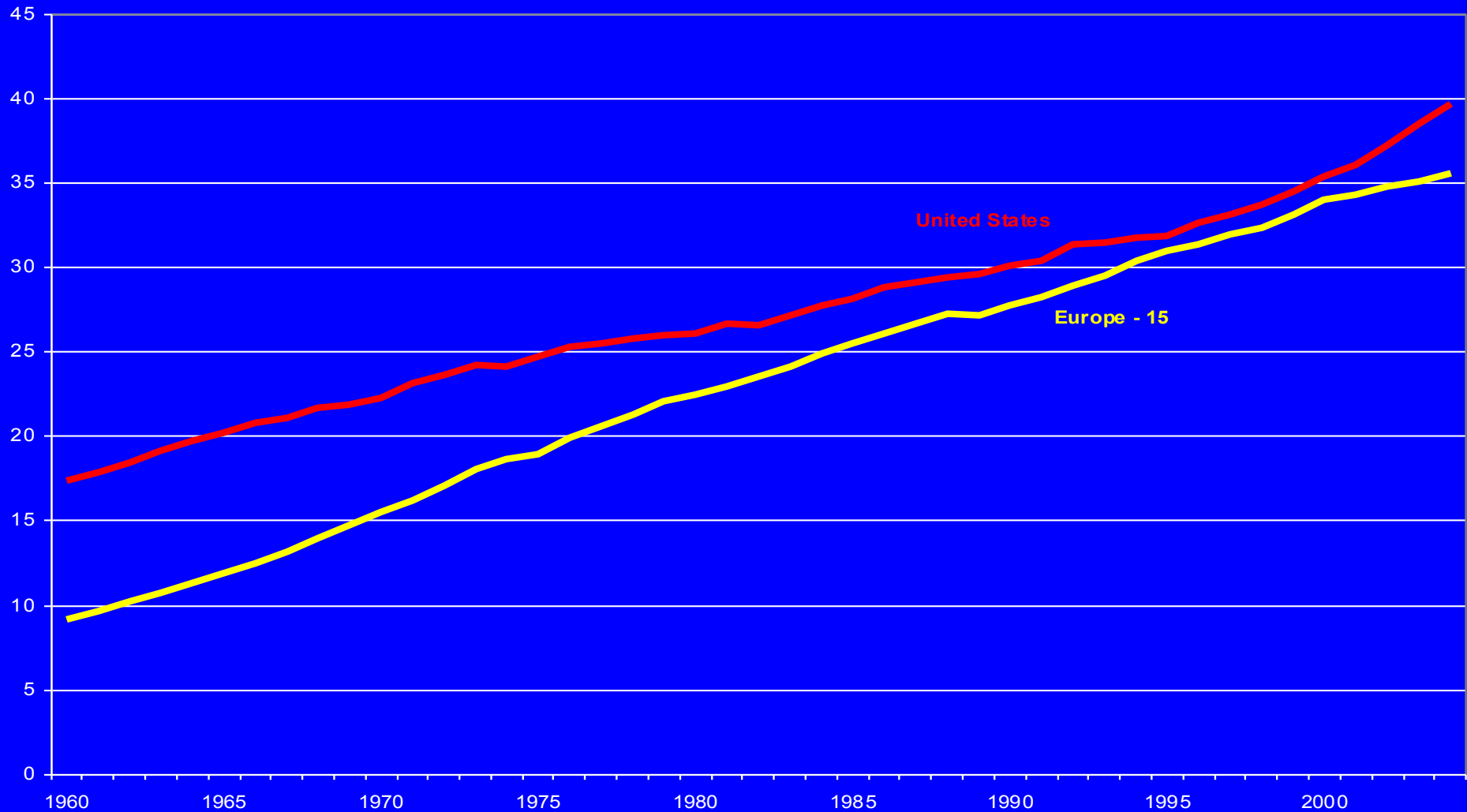
Qualifications

- Raw Growth Comparisons Lead to a *pro-US bias*
- Not enough Attention to U. S. Weaknesses
 - Inequality
 - Medical Care
 - Education
 - Protection and Pork Barrel
- Whenever I bring up a U. S. weakness, there's always Ian jumping to the defense of the American Way (who is Ian?)

Productivity since 1870: Almost Catching Up is Not Enough

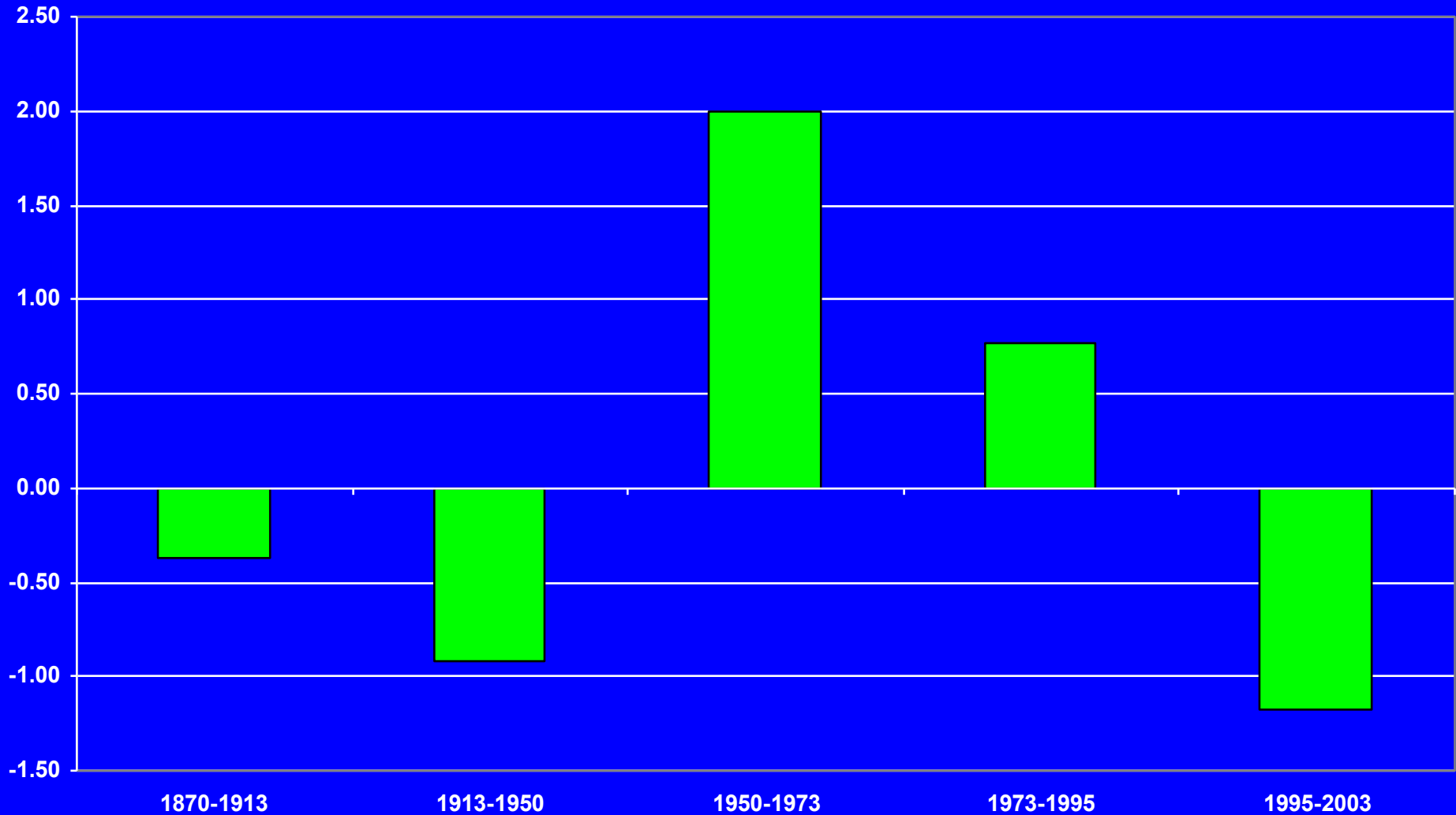


Productivity Post-1960: The Ratio Reaches 96.9% in 1995



133 Years: Falling Behind, Catching Up, Now Falling Behind

Annual Growth Rate of GDP per Hour,
EU minus US, 1870-2003

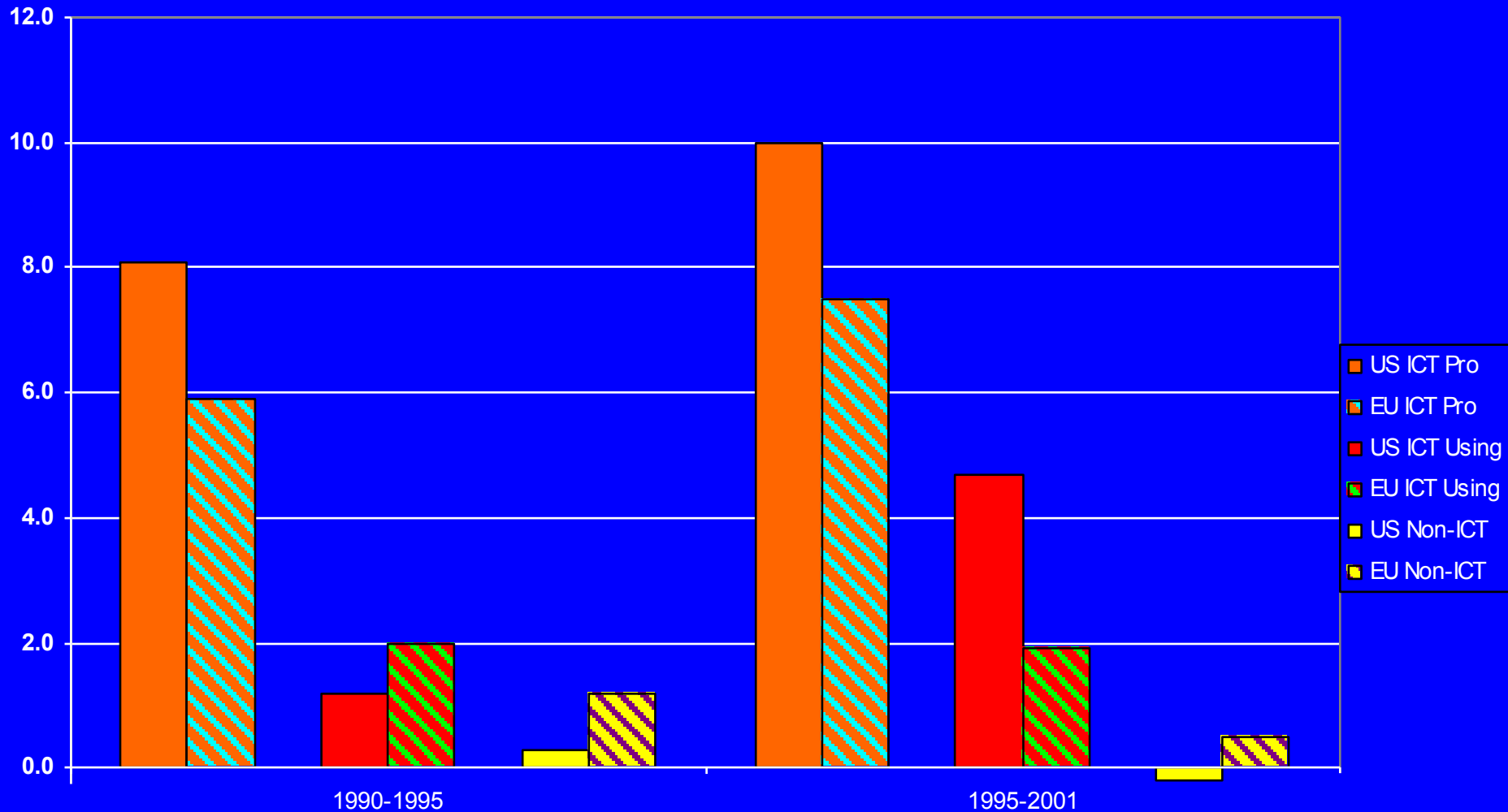


Where is the Difference? The Van-Ark Decomposition

- 55% retail trade
- 24% wholesale trade
- 20% securities
- Rest of the economy: ZERO
- U. S. negative in telecom, backwardness of mobile phones

Finding the Culprit Industries

Output per Hour by Industry Group, EU and US, 1990-2003



The Big Question: What's Wrong with Europe in Retailing?

- U. S. “Big Boxes” (Wal-Mart, Home Depot, Best Buy, Target)
- Stunning Finding from Micro Data: *ALL* of U. S. retail productivity growth has been achieved by new post-1990 establishments and the closing of old establishments. Continuing establishments contributed nothing
- Europe:
 - Land-use regulation, planning approval
 - Shop-closing restrictions
 - Central-city congestion, protection of central-city shopping precincts

The New Conference Board Report: *The Retailing Revolution*

- Startling Numbers
- U. S. Retail Trade Productivity Growth
 - 1980-95, only 2.6 percent per year
 - 1995-2002, jumped to 7.4 percent per year
- U. S. Wholesale Trade
 - Jumped from 4.1 to 8.5 percent over same time intervals

Five Factors Explain Europe's Lagging Behind in Retail

- #1: U. S. got started first in converting retail from low-tech to high-tech
- #2: Europe's regulatory obstacles
 - Regulation within individual countries
 - Inconsistent regulation across national boundaries
- #3: Reduced opportunity for cross-border scale limits Europe's ability to exploit Economies of Scale

The Last Two

- #4: Europe's Trucking Industry was deregulated only in mid-1990s (U.S. in late 1970s)
 - Inhibits complementary innovation in retail and shipping
- #5: Culture and taste differences among European Countries

Product Market Competition Imposes Costs

- Unbridled expansion of Wal-Mart and other U. S. retail “big boxes”
 - Tears up the countryside
 - Destroys Main Street businesses in small towns
- Protection of the European urban retail “pedestrian zone”: Efficiency is not the only priority, other values matter

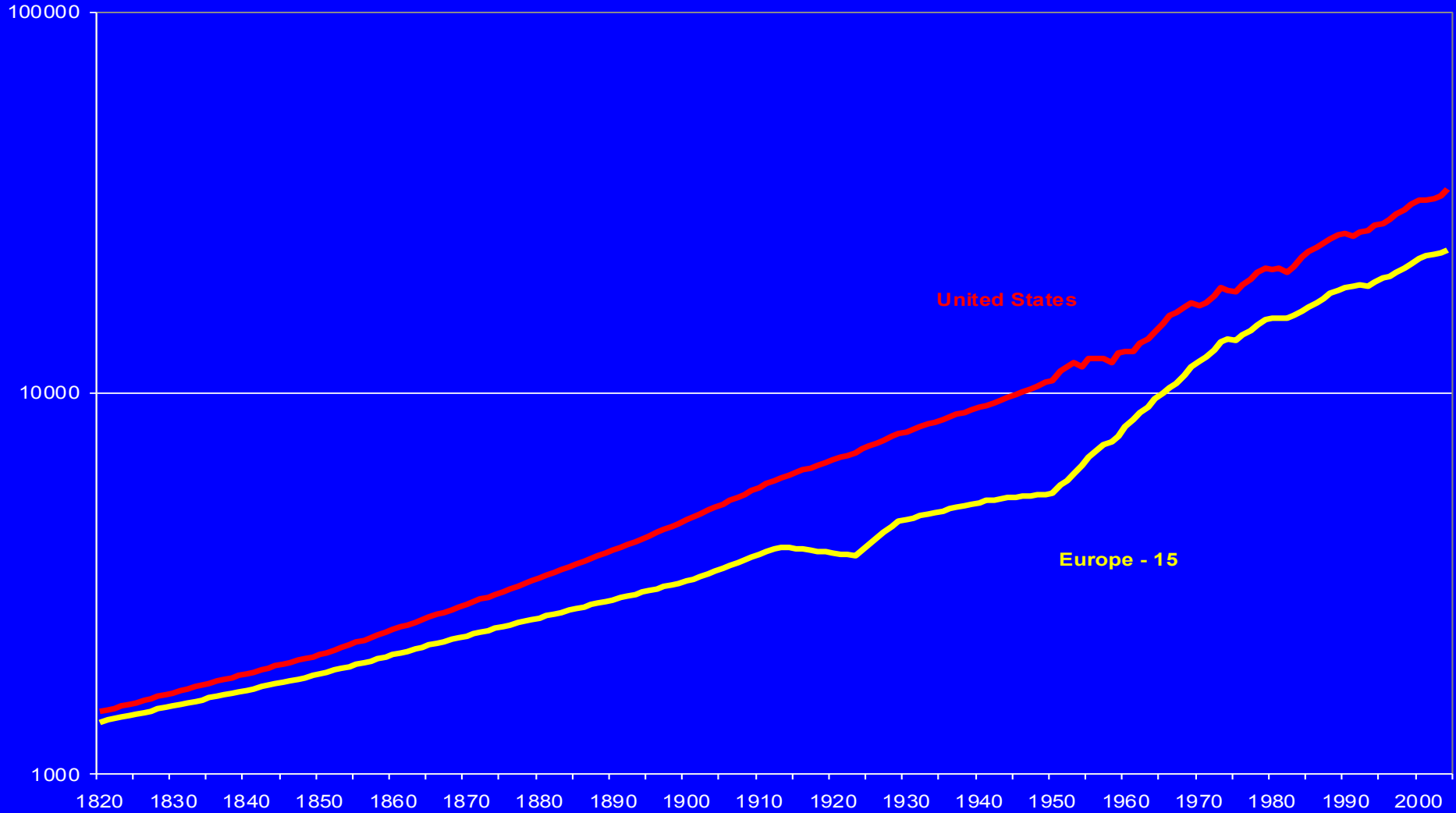
Ian on Wal-Mart

- “Wal-Mart vs. inner-city pedestrian shopping zones”
 - Not an issue of variety vs. homogeneity
 - It’s an issue of aristocracy vs. egalitarianism
- “To promote ancient downtowns at the cost of higher prices aids the rich and hurts the poor”
- My false dichotomy: IKEA in Sweden and a thriving downtown in my own Evanston

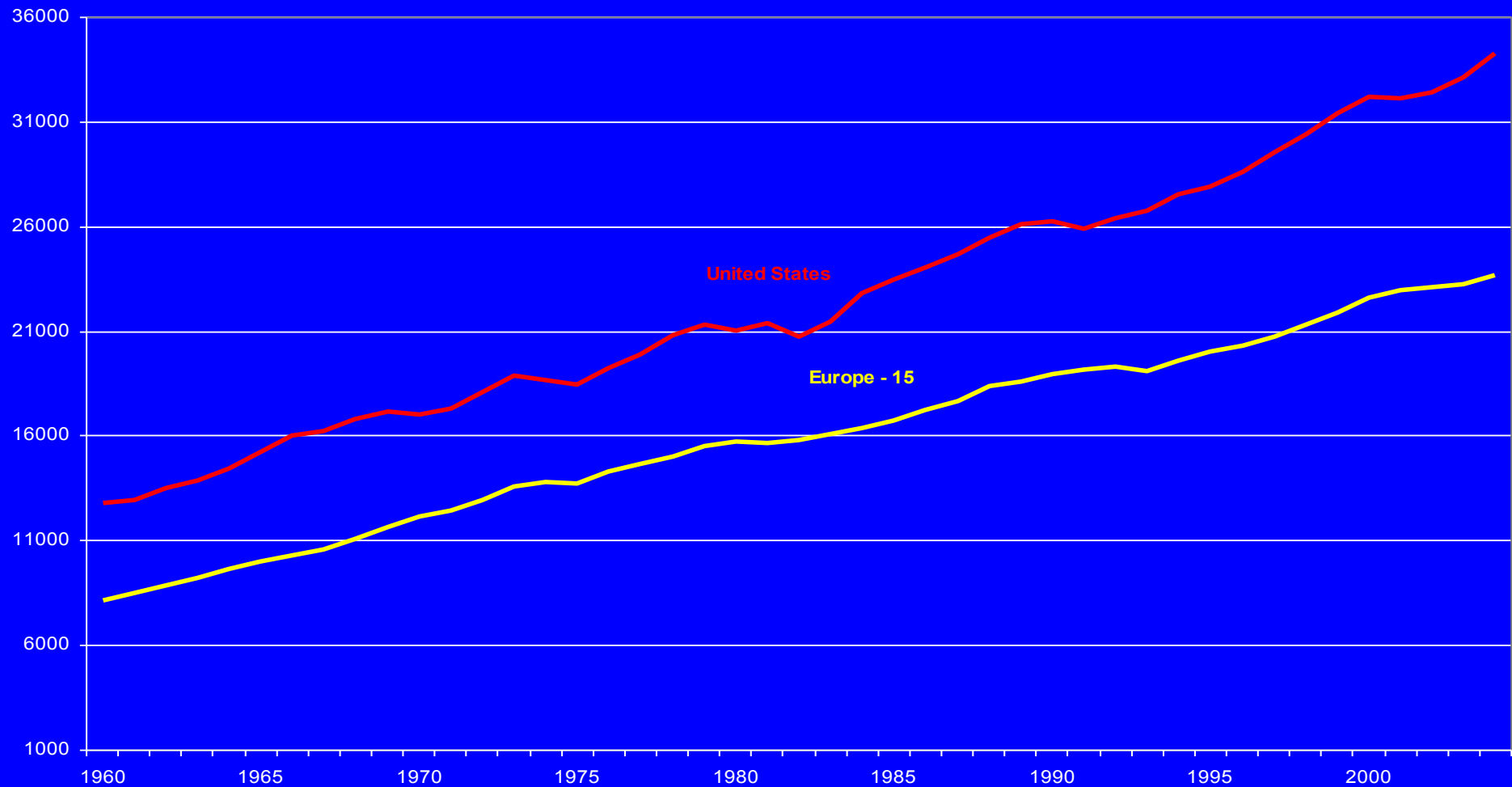
Turning to the Second Big Theme: Welfare Comparisons

- Blanchard (*JEP* Future of Europe Fall 2004)
 - Everything is OK
 - Productivity has caught up to 100%
 - The 75% Ratio for Output per Capita reflects Voluntarily Chosen Leisure
- But He's Wrong on Productivity
- What about Output per Capita?

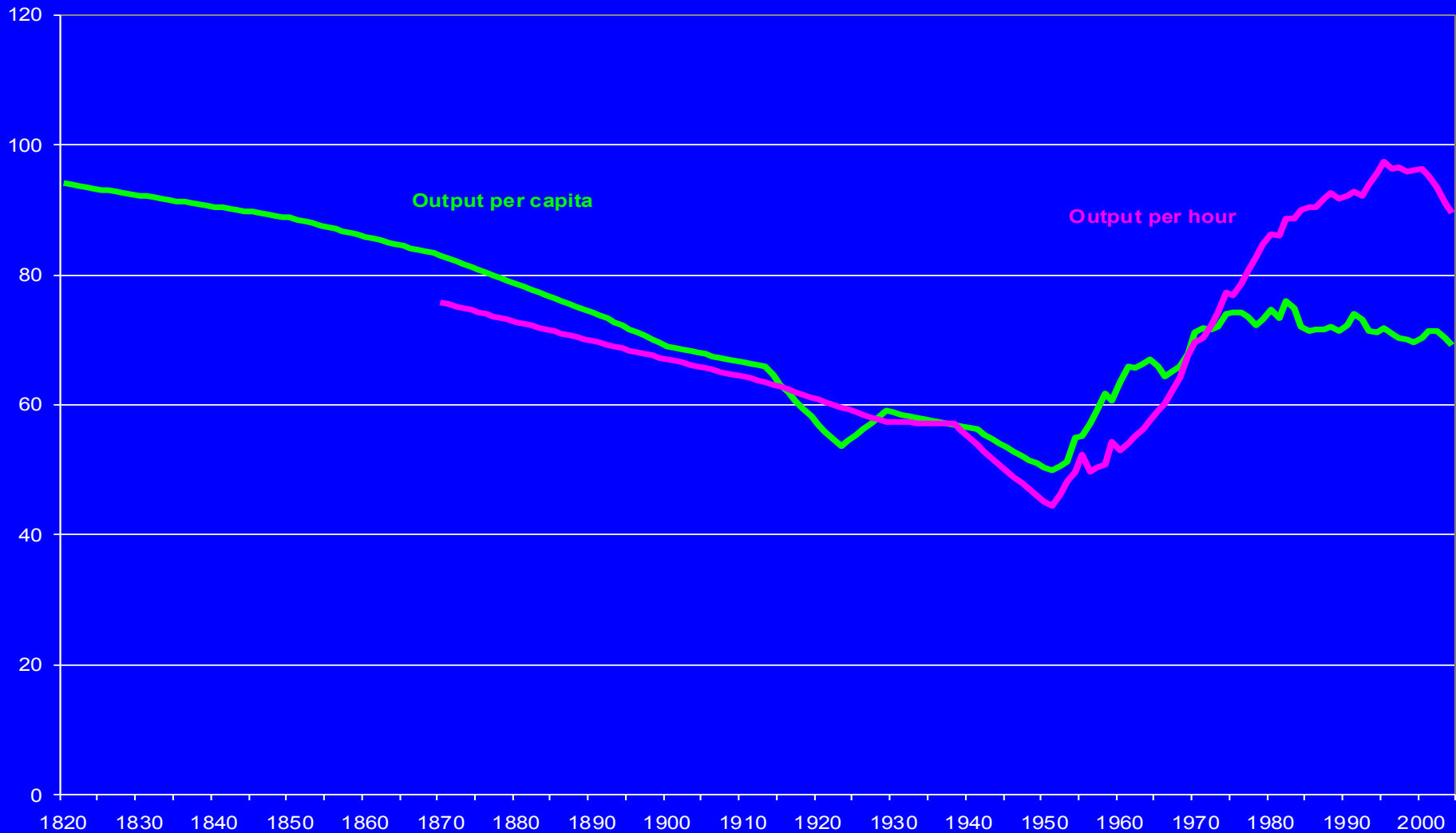
The Broad Sweep of 2 Centuries: Income per Capita



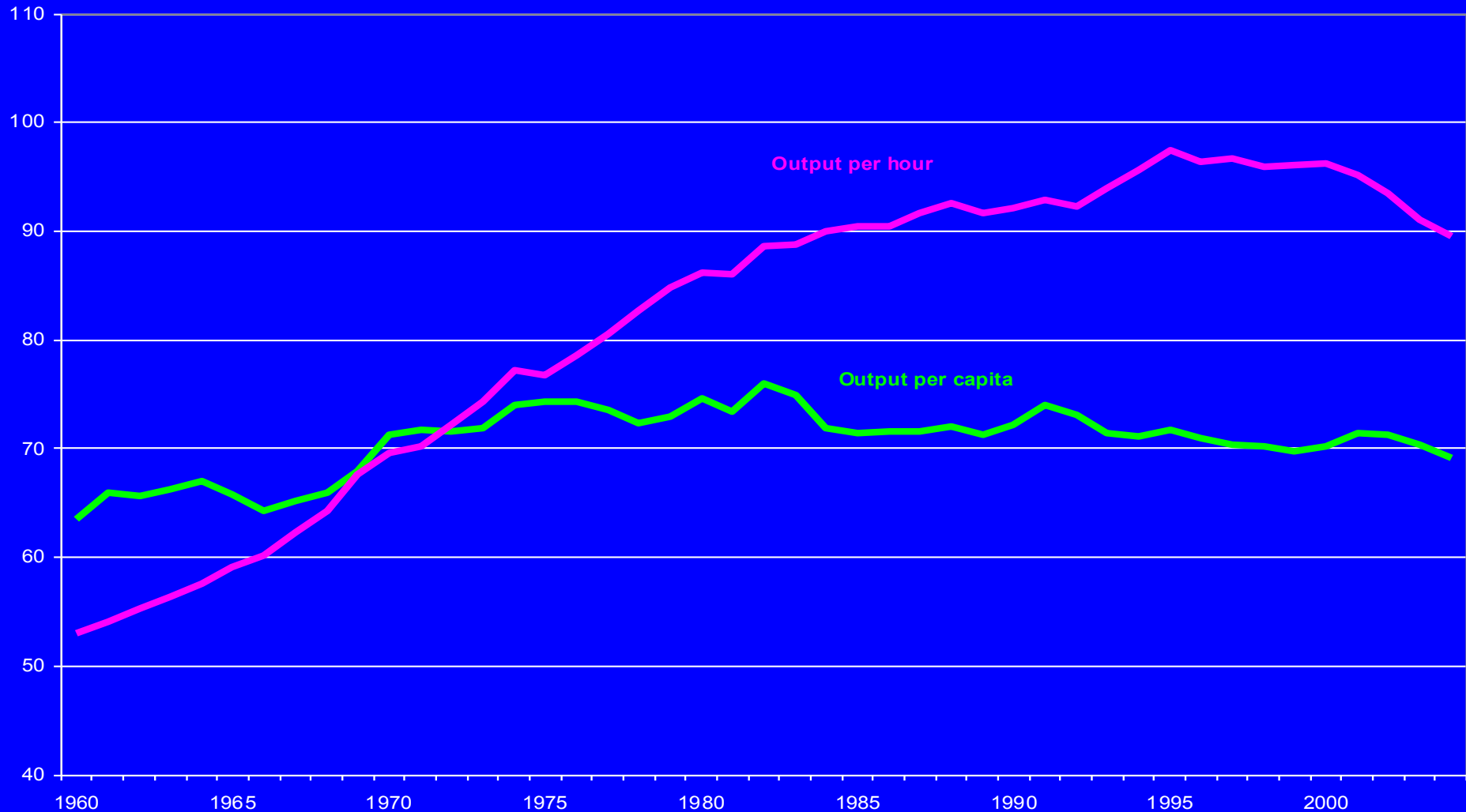
Since 1960: Europe Fails to Converge and then Falls Behind



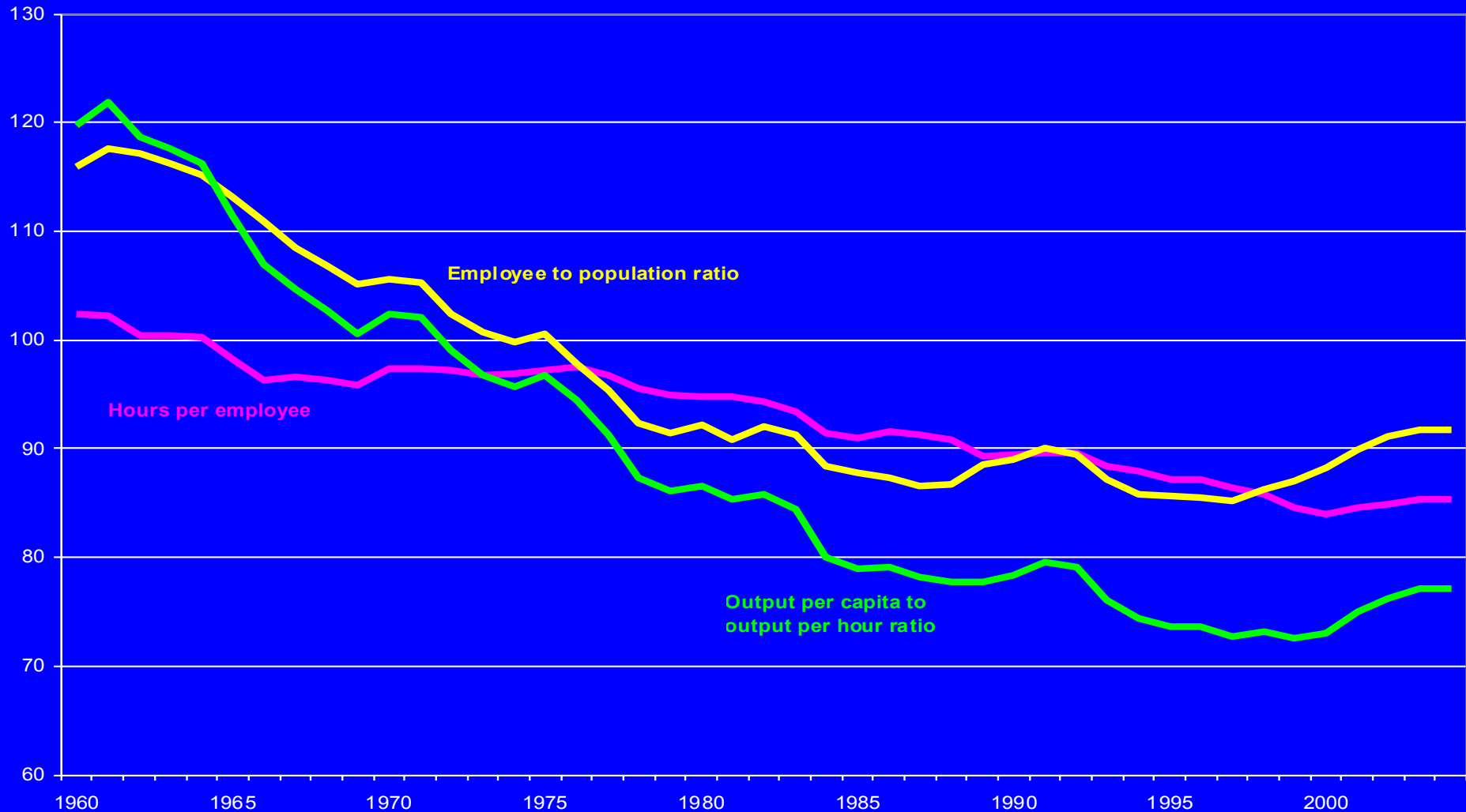
The Europe / US Ratios Are Much More Dramatic



Output per Capita, Europe/US: Stagnation Since 1970



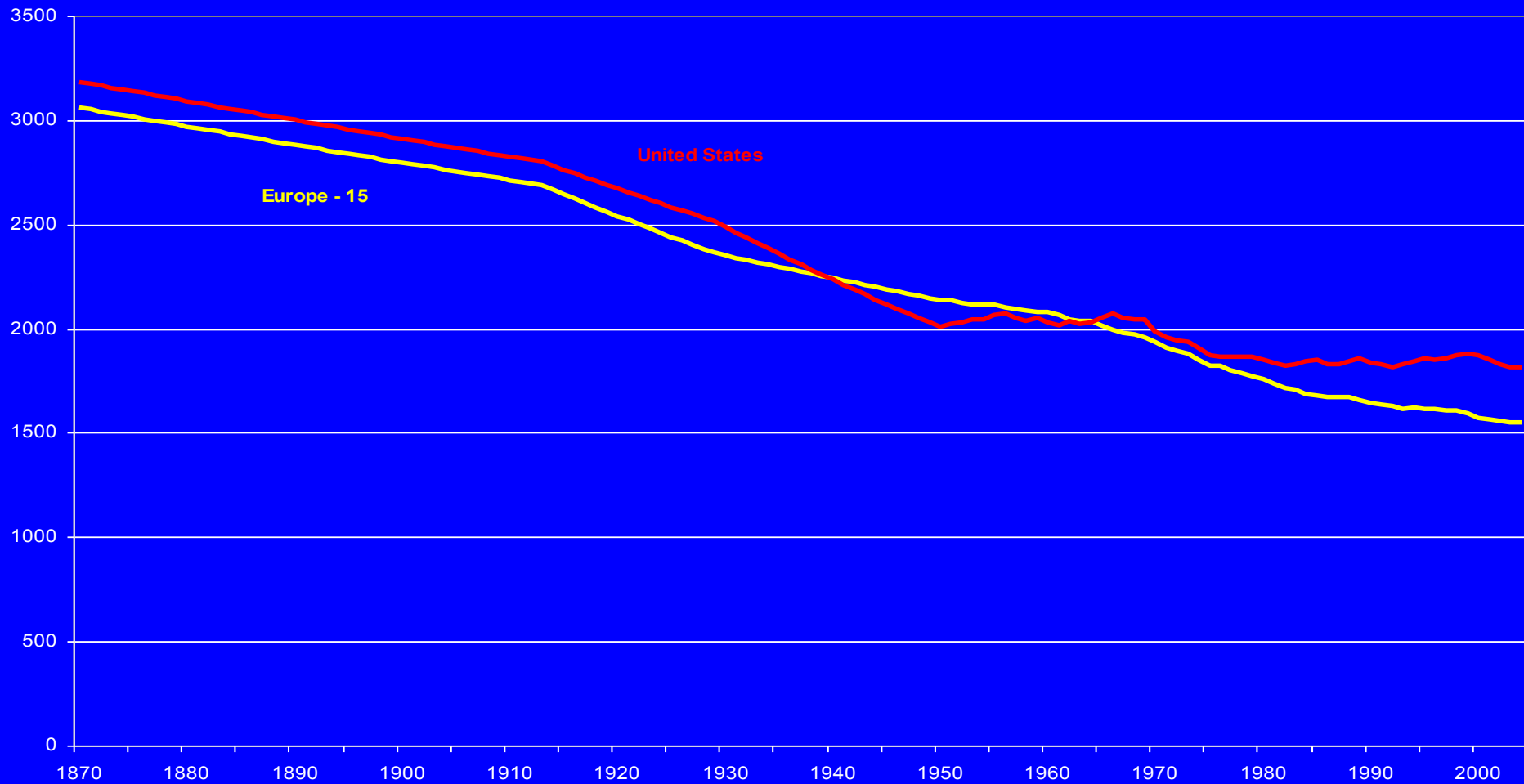
Ratios of Ratios: The Real Clue as to What is Going On



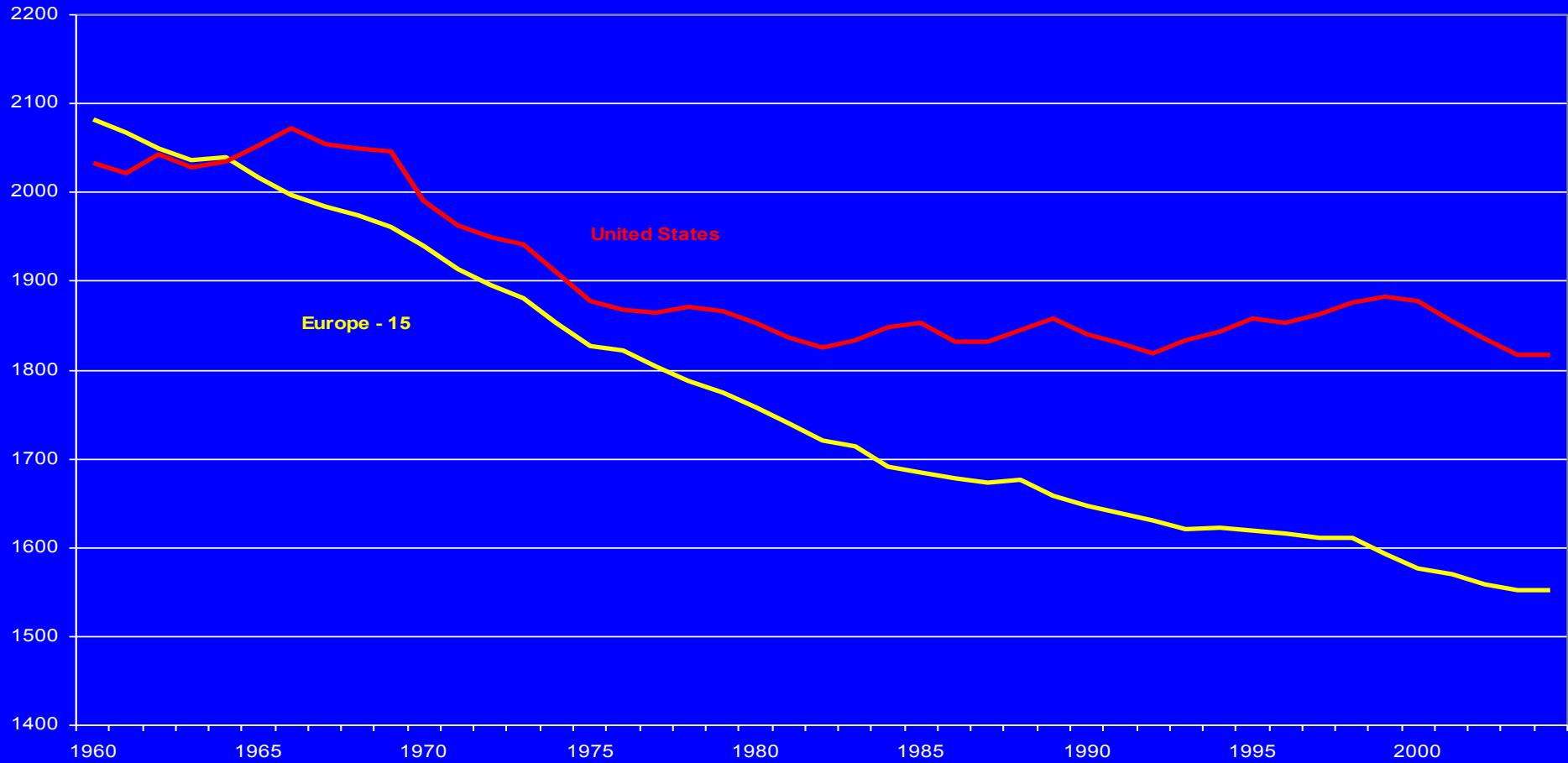
What are the Numbers that Go with these Lines?

	(Y/N) / (Y/H)	H/E	E/N
1960	119.8	102.4	115.9
1995	73.6	87.1	85.6
2004	77.1	85.4	91.7
% Log Change			
1960-1995	-48.6	-16.1	-30.3
1960-2004	-44.1	-18.1	-23.4

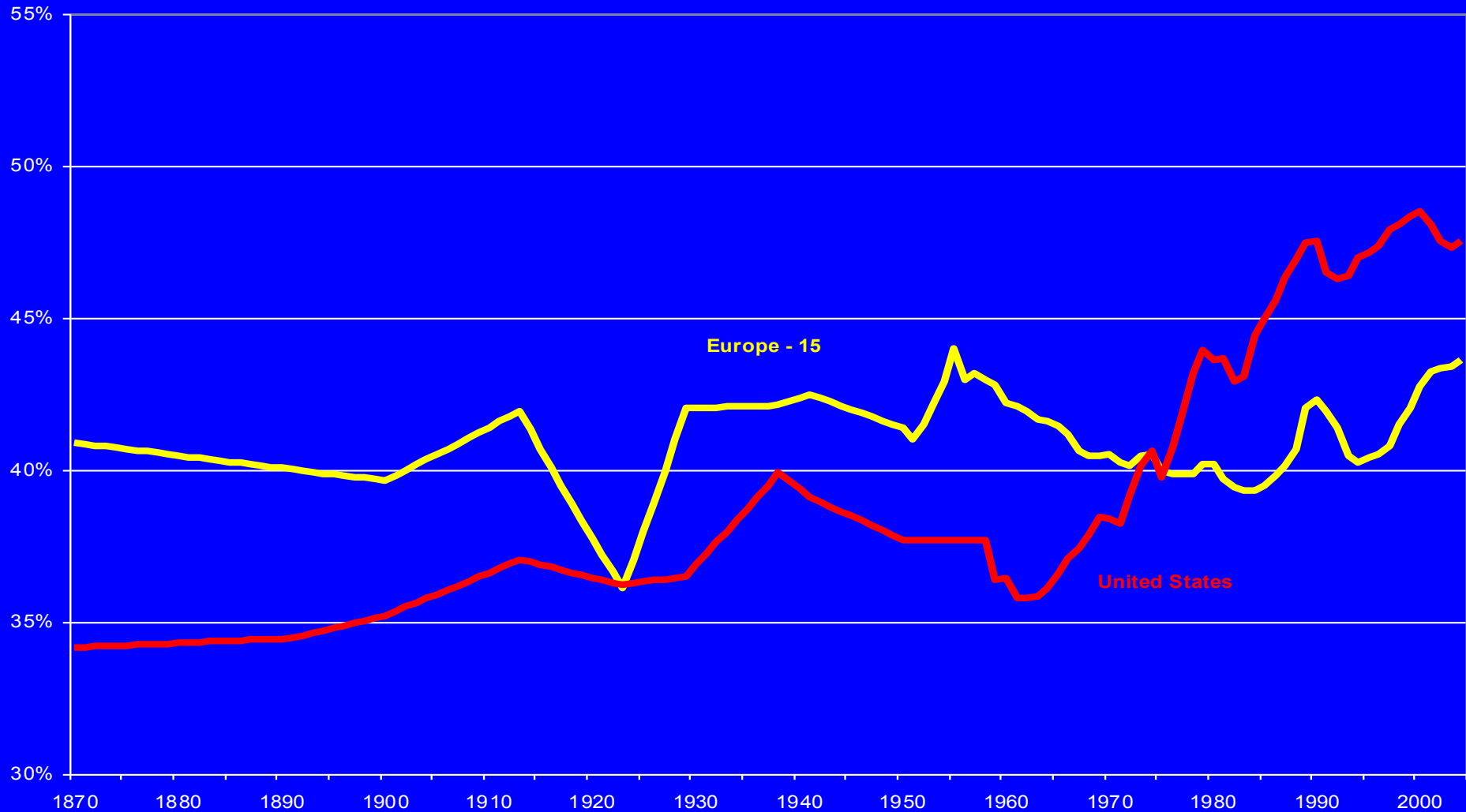
Hours per Employee Declined in Tandem until 1970, then diverged



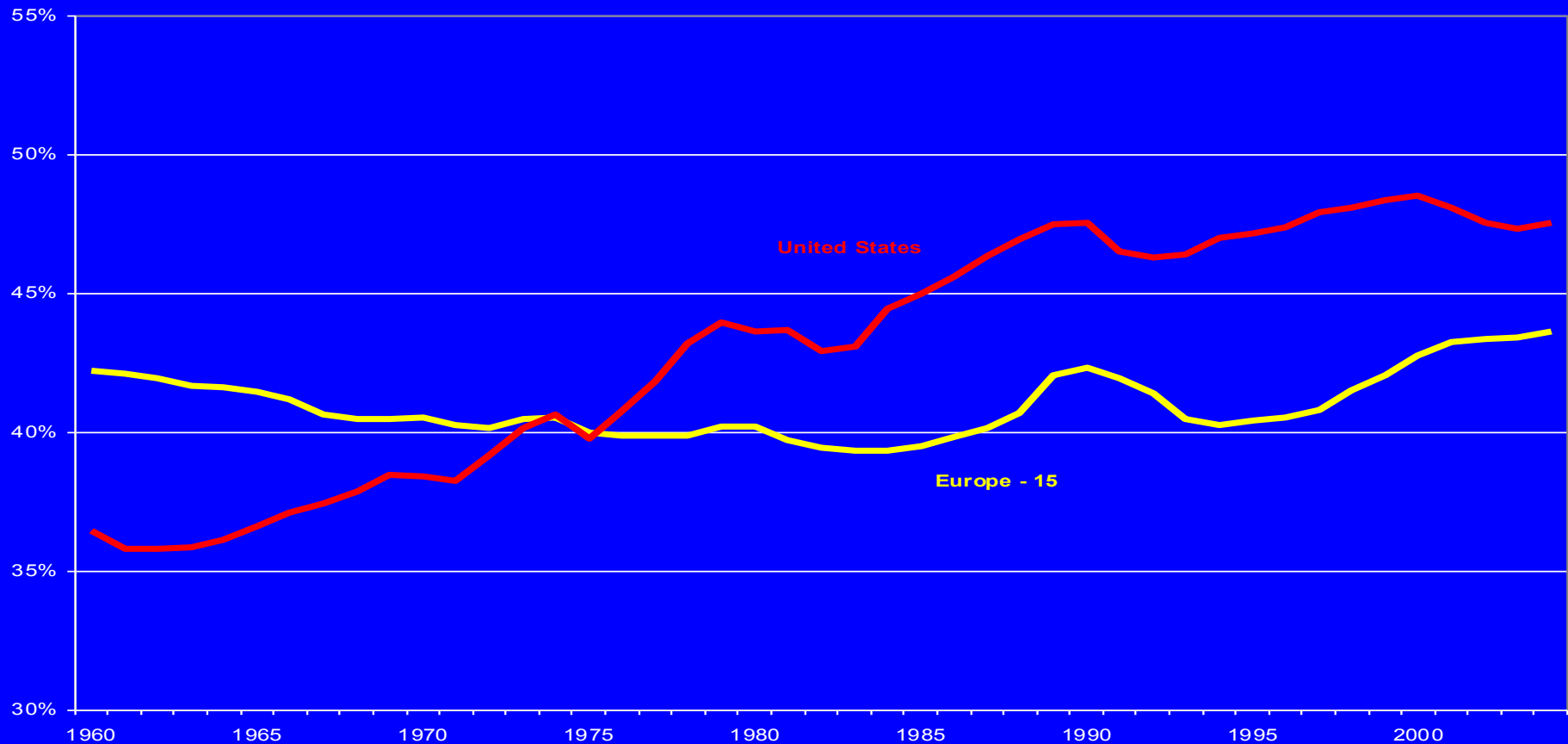
A Close-up of Hours per Employee after 1960



Employment per Capita back to 1870



Employment per Capita: U.S. Women and Teens Marched Off to Work 1965-1990



An Outline of Issues for Discussion

- Europe's failure to converge is not just a matter of voluntary vacations
- Much more of the change 1960-95 was the decline in employment per capita
- Even lower hours are not entirely voluntary
 - Ian: “If the French really wanted to work only 35 hours, why do they need the hours police?”
 - Alesina (*NBER Macro Annual Conference 2005*):
 - Short hours are a victory for unions and parliamentary politics, not for free choice
 - So is early retirement, a major source of falling E/N

What Matters for Welfare is Y/N + Differential Leisure, not Y/H

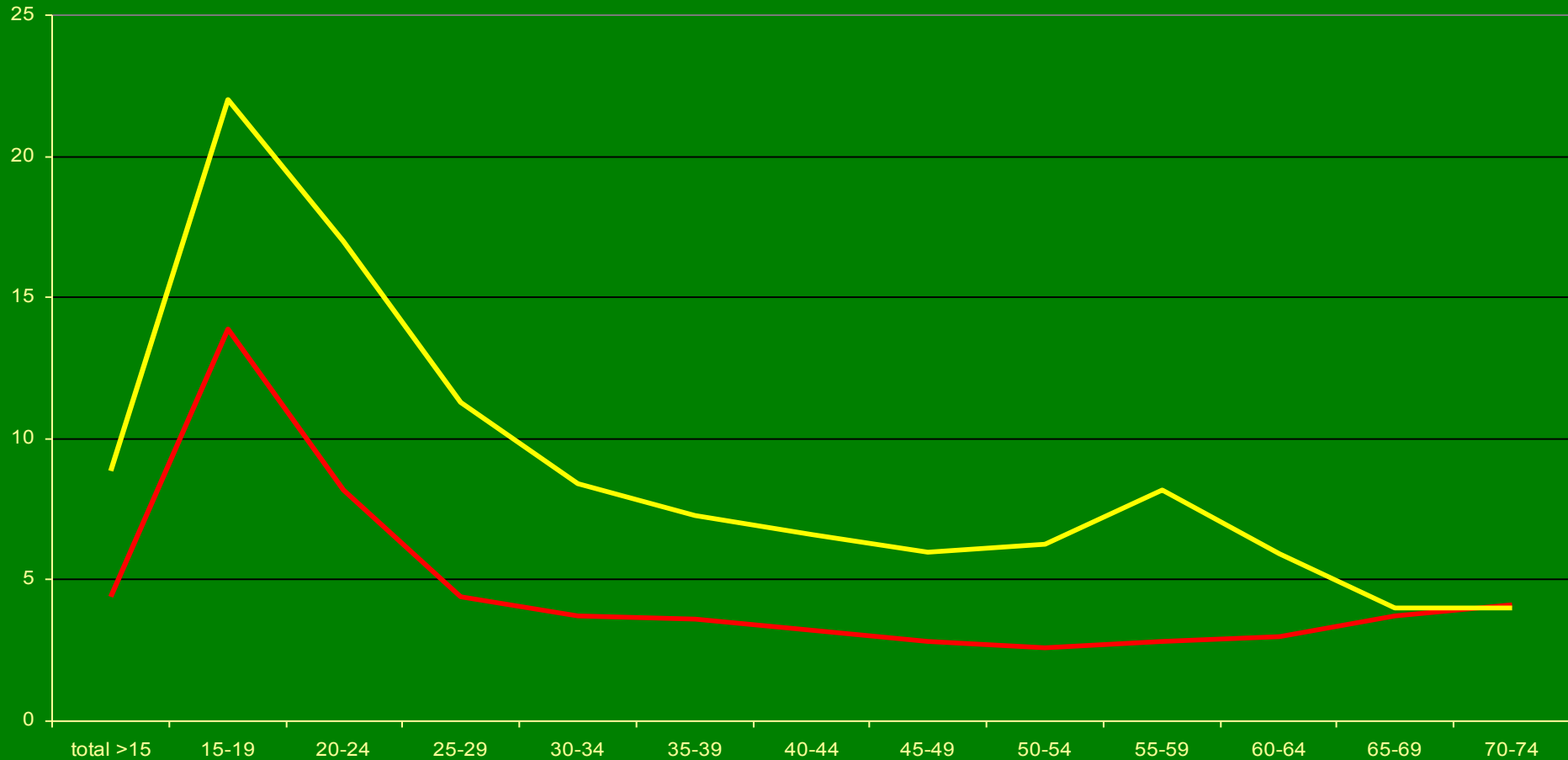
- Europeans have “bought” their high productivity ratio with every conceivable way of making labor expensive
 - High marginal tax rates (payroll and income taxes)
 - Firing restrictions
 - Early retirement (55! 58!) with pensions paid for by working people
 - Lack of encouragement of market involvement by teens and youth

The Decline in Europe's E/N Matters more than H/E

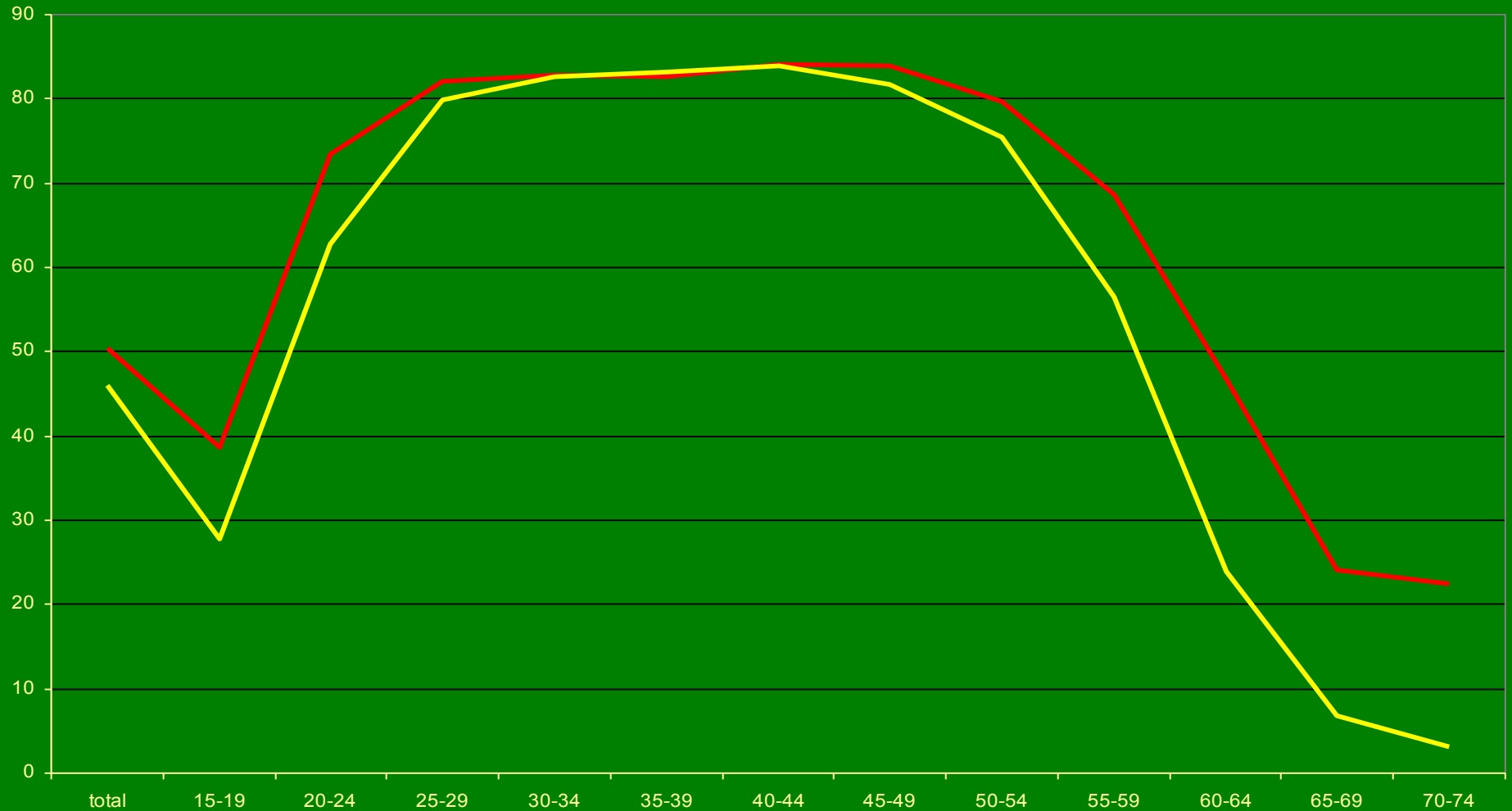
- First, which age groups are suffering from higher unemployment in Europe?
- Second, which age groups experience lower labor force participation in Europe?
- Third, how does it come together in the distribution of low E/N by age group?
- Note: These graphs are for total population by age and blur male/female differences.

Leisure? Unemployment by Age

Unemployment by age

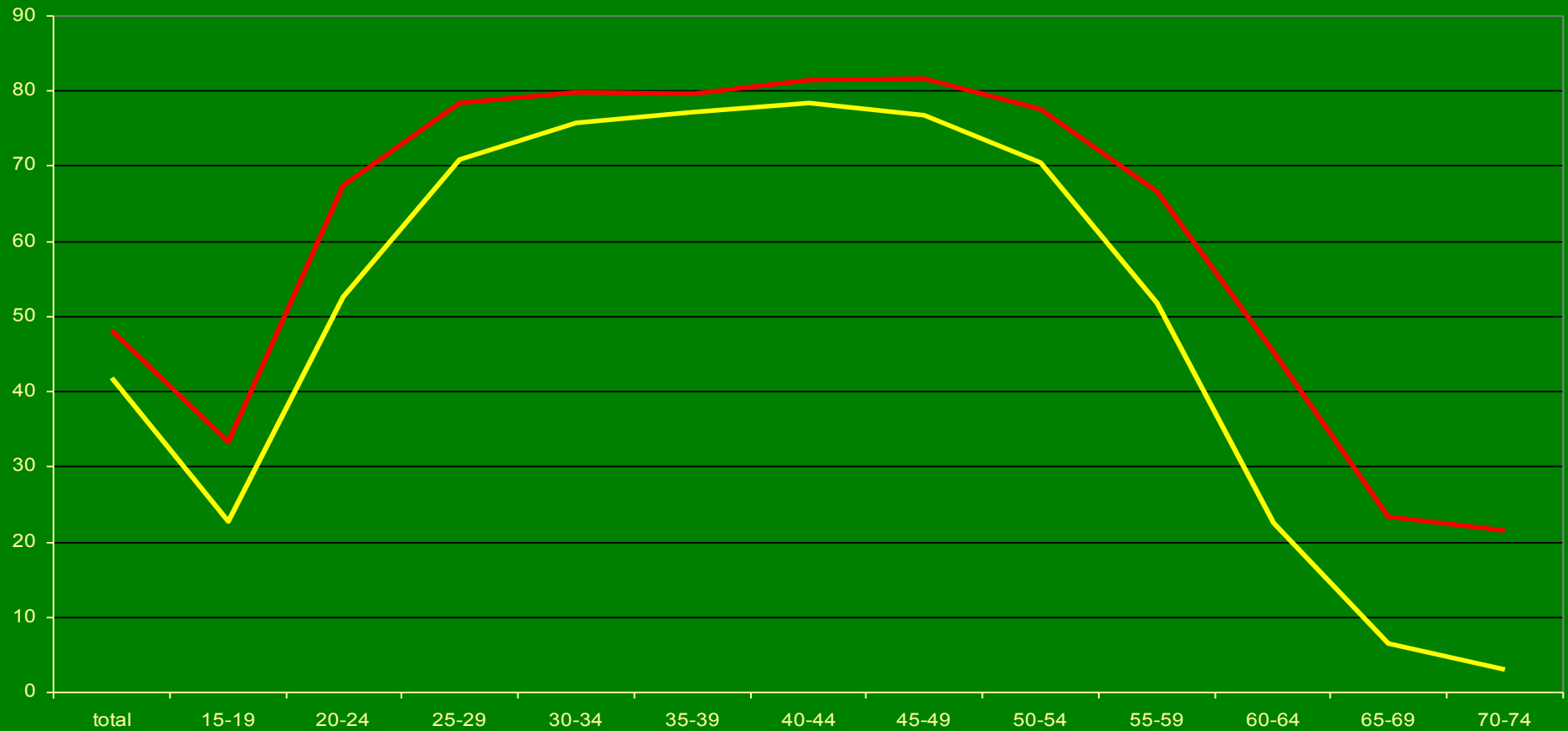


The “Peaked Hump” in European LFPR



Putting it Together: E/N by Age

Employment rates



Decomposing the EU/US Difference in the E/N Ratio

age distribution	unemployment	LFPR	E/N ratio
EU	EU	EU	87.14
US	EU	EU	86.19
EU	US	EU	91.23
EU	EU	US	97.11
US	US	EU	90.77
EU	US	US	102.1

Welfare Aspects of E/N by Age Group

- Youth enter late into Market Employment
- If we are assessing extra European “leisure”, how much if any credit do we give to youth?
 - Disconnected from the market economy
 - American youth are expected to work
- Link with government support of higher education: tuition grants in Europe vs. peer-reviewed research grants in US
 - Plus state university subsidies

The Welfare Effect of Early Retirement: Back-of-Envelope Handout

- Baseline: work age 20-65, retire 65-84
- No saving, investment
- 30% tax finances pay-as-you-go pensions with balanced govt budget
 - Tax finances equality of consumption in retirement to consumption during work years
- Alternative retirement age at 55 requires tax increase to 45.6%, 25.1% decline in consumption during work years and retirement

Welfare Valuation of Leisure

- Work time is chosen to equate marginal utility of leisure to after-tax wage
- Diminishing marginal utility of leisure
 - Infra-marginal leisure valued $>$ wage
 - Extra-marginal leisure valued $<$ wage
- Back-of-envelope.
 - Value weekday and weekend leisure of both workers and retired = $4/3$ after-tax wage
 - Value hours switched from work to retirement = $2/3$ after-tax wage

Welfare calculation

- With 55 retirement age, after-tax wage is 25% less
- Extra hours switched from work to retirement leisure are low-valued (2/3)
- Total welfare = market consumption plus total value of leisure
- Market consumption declines 25.1 percent, welfare declines 22.6 percent, ratio 90% (i.e., leisure offsets 10%)

Conclusion about Leisure Offset

- Europe's decline in H/E, not all of this is voluntary (Alesina)
- Europe's decline in E/N due to unemployment and low labor force participation of youth and early retirees, virtually no leisure offset
- Freeman-Schettkat
 - Part of difference in H/N represents not leisure but household production
 - German mothers cook at home, American mothers go out to eat

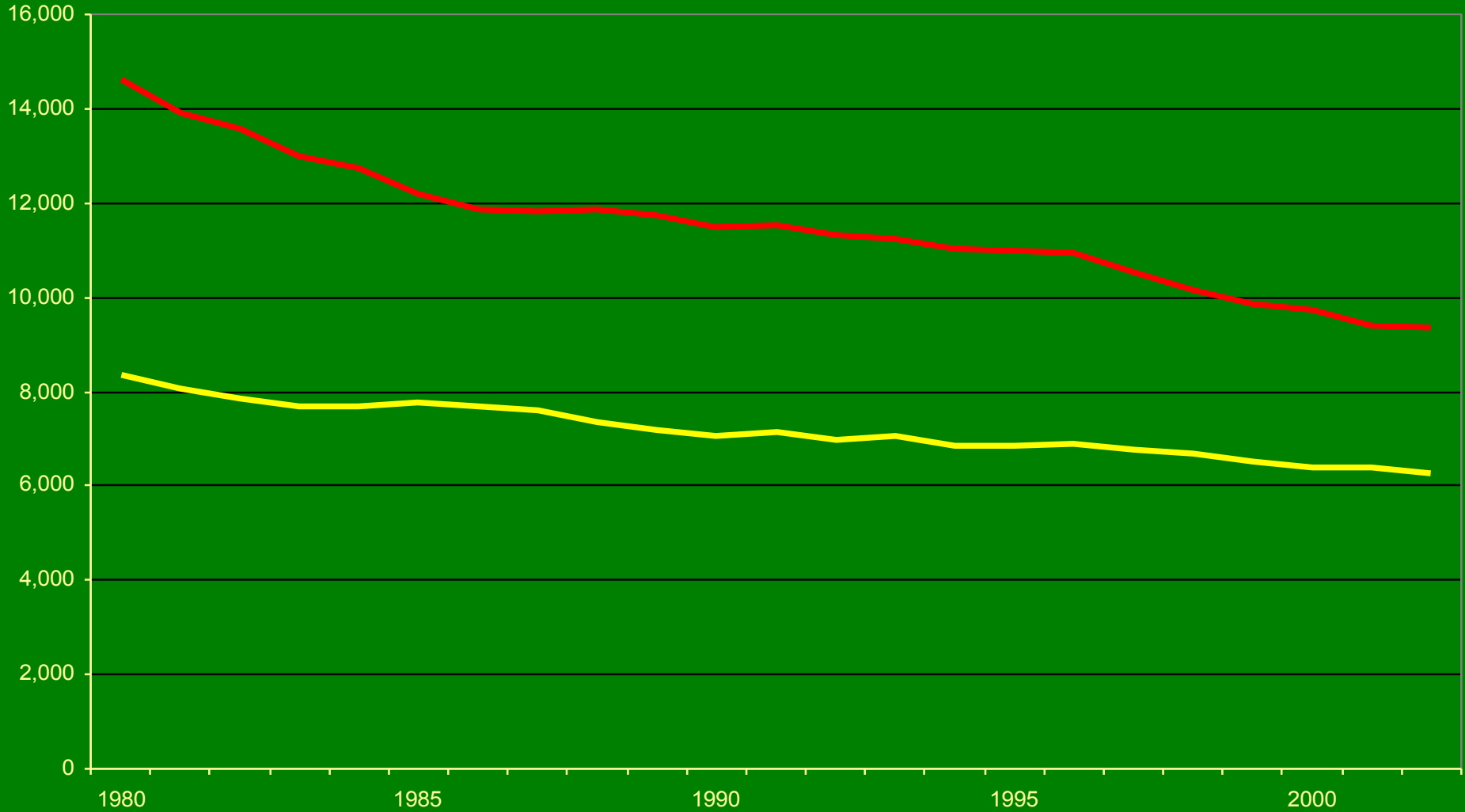
Turn the Tables on the U. S.: The “Disconnect” between Welfare and PPP-Adjusted GDP

- GDP Exaggerates U. S. GDP per Capita
 - Extreme climate, lots of air conditioning, low petrol prices, huge excess energy use
 - U. S. urban sprawl: energy use, congestion
 - Crime, 2 million in prison
- How much is this worth?

A Shrinking Explanation: Declining Btu / GDP



The EU-US Difference is only 2% of GDP



Other Additions or Subtractions from Europe's Welfare

- Urban Congestion?
 - London vs. NY? Paris vs. Chicago?
 - Time spent in London underground vs. in a Chicago automobile?
- Prisons, perhaps 1% of GDP
- Undeniable U. S. superiority: housing
 - People value interior square feet (2X in US)
 - People value exterior land (4X in US)

Ian on Urban Density

- “We overspend on highways, they overspend on trains”
- “We live in suburbs and have long commutes, they live in cramped homes and are closer to work”
- “We have options: in Chicago I can live in a suburb and drive OR live in an apartment and walk to work”
- However, many Americans lack such options
 - Inner city African Americans seeking suburban jobs
 - Many medium and small cities have virtually no public transit options, and there are few jobs where you can “walk to work”

Putting it Together for 2004

- EU/US Y/N = 68.8
- EU/US Y/H = 89.2
- Raise Europe:
 - 67% of H/E difference (11.8) is leisure = 7.9
 - 10% of E/N difference (8.6) = 0.9
 - Half of Energy use difference = 1.0
 - Prisons and other = 1.0
- Europe's welfare vs. U. S. = 79.6

A Solid Reason why the U. S. Welfare Level is Truly Higher

- Hedonic regressions show: people value square feet of housing and exterior land
- The average American housing unit is more than double the average European unit
- The land area is at least 4x, maybe more
- The time cost of commuting may be less when all the delays of public transit are taken into account

Aggregation in U. S., Lack of Aggregation in Europe

- Puzzle is not failure in Europe, it's heterogeneity in Europe
- If you disaggregated the U. S., you'd find similar differences in Productivity growth and IT use:
 - Silicon Valley = Ireland + Finland
 - New England = Denmark + Sweden
 - Austin Texas = Australia
 - Heartland = France or Germany
 - What's Missing in U. S. is Olive Belt (IT+PO+SP+GR)
 - But we've got it south of the border in the Tequila Belt

Finally, A Set of Qualifications about the Apparent U. S. Advantage

- #1. Europe is not Homogeneous
- #2. Secondary Education in U. S.
- #3. Chaotic and Inefficient Medical Care
- #4. Astounding Results on Inequality
- #5. Perverse Public Policies

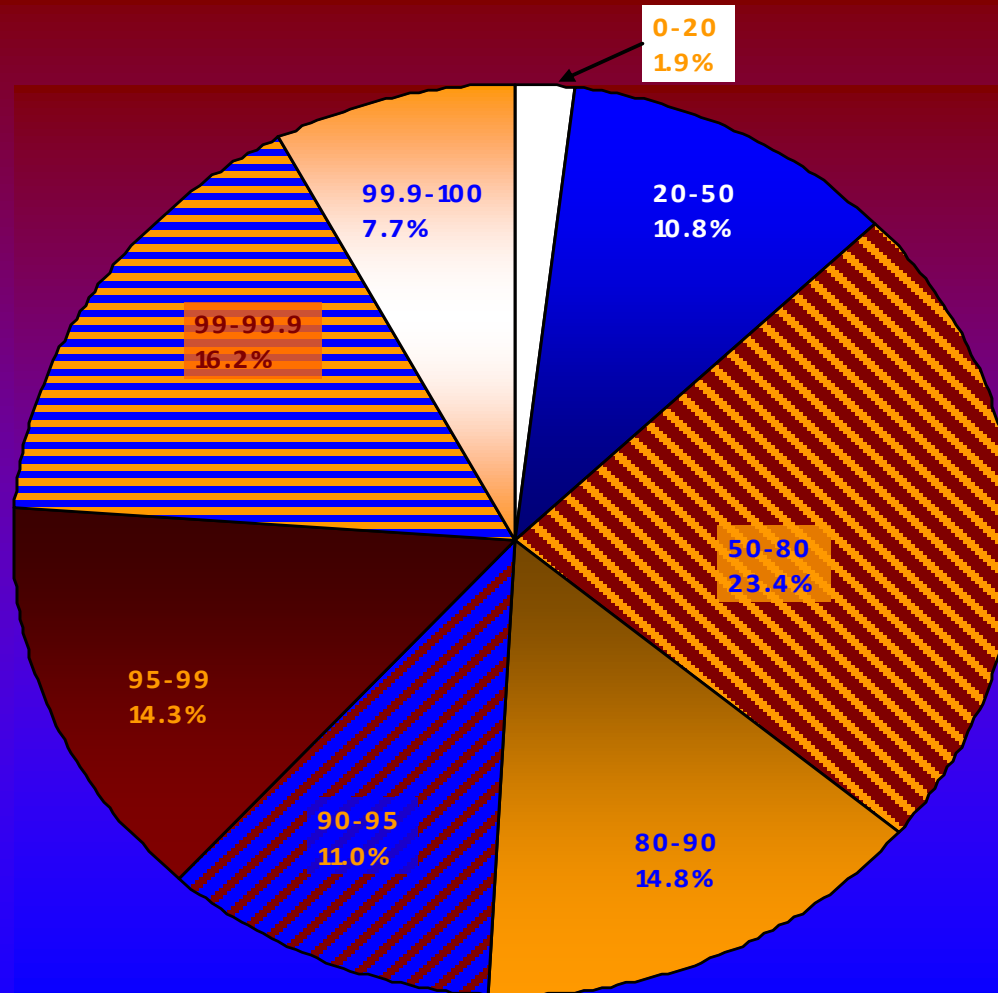
Qualifications about the U. S.

- Education
 - Poor elementary and secondary schools dependent on wildly unequal finance across school districts
 - U. S. ranks low on world league tables of science and math knowledge by teenagers

The U. S. Medical Care Non-System

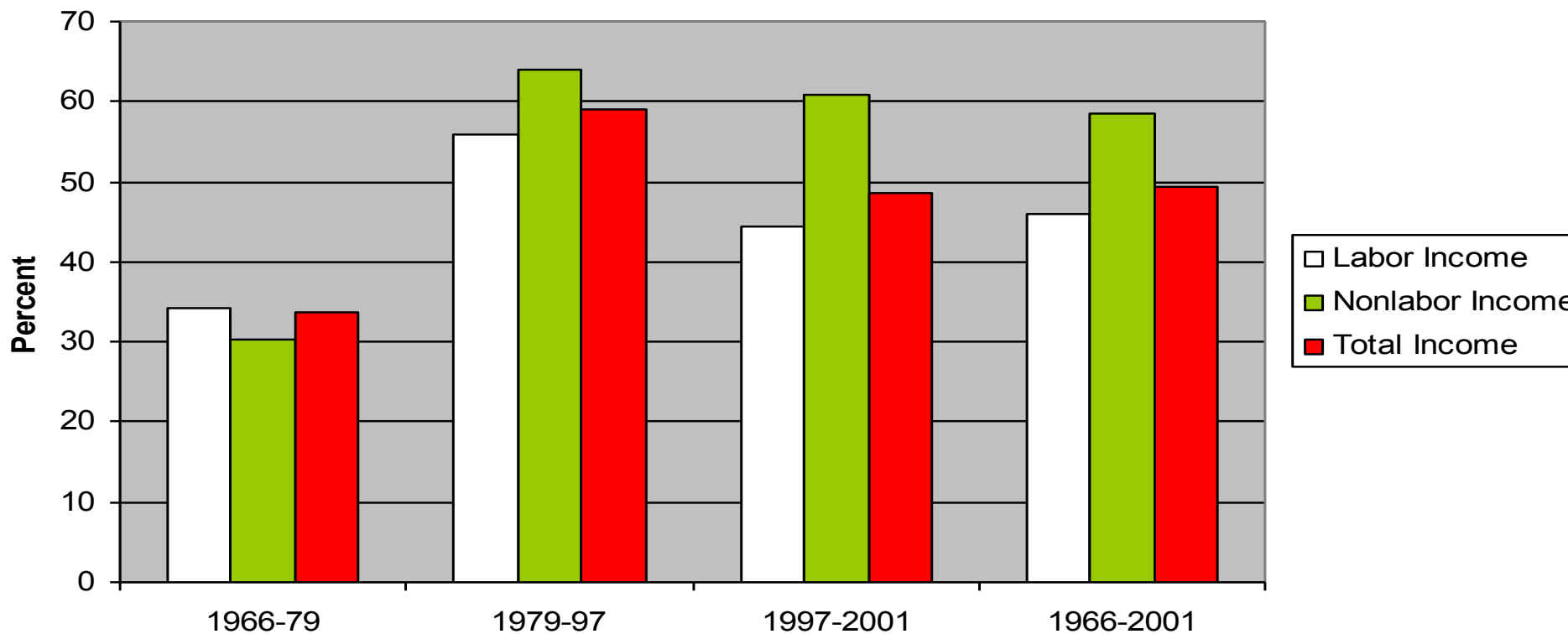
- Medical Care Insurance Tied to Employment, not a Right of Citizenship
 - Artificial creation of part-time jobs
 - Toyota builds its new plant in Canada
 - The noose around the neck of the legacy firms (GM and Ford)
- 4% of GDP wasted on paperwork
- Economists are Making this worse – confusion about moral hazard

Some New Results About Inequality: Shares of Growth in Real Wage and Salary Income, 1997-2001



Percent of Real Income Growth Accounted for by Top 10 Percent

Figure 12.
Share of Top 10 Percent in Increase of Real Income, \$2000, Selected Intervals, 1966-2001



Government Intervention in the U. S. is off the Rails

- Farm subsidies: hurt LDCs, promote obesity
- Steel Tariffs
- Medical Care: Run in the interest of giant insurance and pharmaceutical corporations
- Starvation of Public Transit and Subsidization of Interstate Highways
- Pork-Barrel Energy Bill and Transportation Bill, the Bridge to Nowhere in Alaska
- Local Zoning and Inequality of School Finance
- Tax Deductibility of Mortgage Interest

Ian on Farm Subsidies

- “To complain about American subsidies seems odd considering that the average cow in Europe earns more income in subsidies than the median income of the world”
- OK, Europe and U.S. are equally guilty on farm subsidies
- The rest of my list is intact

Conclusion: Persistence of American Exceptionalism

- America:
 - Long work hours, short vacations
 - Low-density metro areas
 - High fertility
 - Role of immigration interacts with flexible labor markets

Are Tastes Endogenous?

- Europe and U. S. have Settled down in Two Different Equilibria?
- Can One Side Converge to the Other?
- Policies, Constraints, Influence Tastes
- The Best Prediction is: Still Different in 50 years

Let Ian Have the Final Word

- “In Europe you have to pay higher prices so that rich people get variety”
- “If you want half-decent higher education, you have to leave the continent”
- “If you’ re poor, you can’ t rise because it’ s hard to start a company and you can’ t work more than 35 hours per week”
- “Show me a European Richard Grasso (former CEO of the New York Stock Exchange), a man who didn’ t go to college and got fired for making *too much* money”